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FEDERAL COMMUNICATIONS COMMISSION  
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**BEFORE THE  
Federal Communications Commission  
WASHINGTON, D.C.**

Implementation of Sections of the )  
Cable Television Consumer Protection )  
and Competition Act of 1992 )  
Rate Regulation )  
Further Notice of Proposed Rulemaking )

MM Docket No. 92-266

COMMENTS  
OF  
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## APPENDIX

S. BESEN & J. WOODBURY,  
 "AN ANALYSIS OF THE FCC'S CABLE TELEVISION  
 BENCHMARK RATES," June 17, 1993

## SUMMARY

TCI's Comments demonstrate that there is no sound basis in econometrics or law to order an additional rate cut (from 10% to 28%) for cable systems subject to rate regulation. As explained in the attached Appendix, a study undertaken by Dr. Stanley M. Besen and Dr. John R. Woodbury, the Commission's econometric analysis cannot provide justification for further rate reductions. The number of effectively competitive community units available for analysis if the below 30 systems are deleted is 46 -- simply too small a number to provide a reliable basis for regulation. Moreover, there are numerous problems with the Commission's analysis, indicating that even the 10% competitive differential is not one in which there can be much confidence.

Similarly, as a matter of law, the Commission cannot order further rate reductions by excluding all cable systems with less than 30% penetration from the data selection process. The Cable Act and legislative history quite clearly evince Congress' intent to bind the Commission to the terms of the Act defining effective competition. In any event, it would be arbitrary and capricious for the Commission to selectively apply the statutory definitions of effective competition to form some but not all of the data without reviewing each of the responses already submitted, and further considering alternative measures of effective competition.

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## Further Notice of Proposed Rulemaking

Tele-Communications, Inc., by its attorneys, hereby submits its Comments in response to the Further Notice of Proposed Rulemaking in the above-captioned docket.<sup>1</sup> The Further

I. THE COMMISSION'S ECONOMETRIC ANALYSIS CANNOT FORM A SUSTAINABLE BASIS FOR A FURTHER RATE REDUCTION OF 28%

TCI requested Drs. Besen and Woodbury to undertake an analysis of the econometric effort by which the FCC derived its benchmarks and required a 10% rate cut for systems not subject to "effective competition" as defined in the statute. This analysis, submitted as an Appendix to these Comments, demonstrates that the Commission's effort cannot provide justification for further rate reductions.

Drs. Besen and Woodbury report several key observations and conclusions. First and foremost, they reveal that the Further Notice's proposal to delete the "below 30" community units from the analysis would leave the Commission with observations on only 46 cable community units upon which the FCC would regulate over 11,000 systems nationwide.<sup>3</sup> An even smaller number come from overbuilt systems. As a matter of science and common sense, this number is simply too small to provide a basis for regulation -- much less a basis to order the dramatic reduction in rates that is being considered. An effort to utilize this small a number to undertake such a large risk leads the Commission out of the world of legitimate scientific effort into the realm of politically expedient numerology.

Moreover, as explained in greater detail by Drs. Besen and Woodbury, the econometric effort even in its existing state is at best shaky. There are numerous indicators that even the

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<sup>3</sup> Besen & Woodbury at 32.

10% competitive differential is not one in which one can have much confidence. As stated in the attached paper, there are at least four major concerns that can be identified: 1) the equation itself may be misspecified in that it assumes, evidence to the contrary notwithstanding, that the only reason for different behavior of competitive and non-competitive systems is the presence or absence of competition; 2) the equation may also be misspecified because it assumes that the competitive differential is the same for all systems, regardless of the number of subscribers they serve; 3) the number of effectively competitive systems, even with the below 30 systems included, is small relative to the policy task; and 4) the uneven nature of the equipment data may have prevented the Commission from deriving accurate estimates of the competitive differential.

To assess the significance of these problems, Drs. Besen and Woodbury re-examined the Commission's data and statistical methodology. For example, Drs. Besen and Woodbury re-estimated the Commission's basic equation for five different subscriber size classes, and found results very different from the FCC's 10% differential -- including a negative differential for community units in the 10,001-50,000 subscriber category. In other words, the results for "competitive" systems predict rates that are 10% higher than "non-competitive" rates for this size class. Further analysis also suggest that the Commission's basic equation is misspecified.<sup>4</sup>

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<sup>4</sup> Id. at 22-23.

As a check on the Commission's analysis, the attached Appendix also examined data reported earlier by the General Accounting Office to produce alternative estimates of the competitive benchmarks. Examining GAO ratios of the rates for regulated and unregulated systems in 1986 to assess the competitive differential shown there, they derive an average differential of only 5%.<sup>5</sup>

The analysis of Drs. Besen and Woodbury suggests strongly that the degree of confidence the Commission has shown in its analysis is unwarranted. Taking that analysis one step further, by halving the already small sample of effectively competitive systems, would reduce the degree of confidence to close to zero.

II. THE COMMISSION CANNOT LAWFULLY ORDER FURTHER RATE REDUCTIONS BY EXCLUDING CABLE SYSTEMS WITH LESS THAN THIRTY PERCENT PENETRATION FROM THE DATA SELECTION PROCESS

A. The Terms of the Cable Act Defining Effective Competition are Binding on the Commission

To implement its responsibility to ensure reasonable

rates of cable systems that are subject to effective competition under each of the three independent statutory criteria.<sup>6</sup>

The Notice now asks whether it can lawfully exclude the rates of cable systems with less than 30 percent penetration in its data selection process even though such systems are defined as systems that face effective competition under the Cable Act.<sup>7</sup> The answer is no. The Commission is lawfully bound by the statutory definition and cannot simply ignore it to achieve a certain result.<sup>8</sup> An agency's reasons and actions cannot "deviate from or ignore the ascertainable legislative intent."<sup>9</sup> Thus, to properly fulfill its Congressional mandate, the Commission's competitive benchmark must include, as a matter of law, data from

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<sup>6</sup> Cable Act, § 623(b)(1), 47 U.S.C. § 543(b)(1). Cable service rates are only regulated under the Cable Act if the cable system is not subject to "effective competition." The Cable Act defines "effective competition" as 1) where the system serves fewer than 30 percent of the households in the franchise area; 2) where the franchise area is served by at least two unaffiliated multichannel video programming distributors each of which offers comparable video programming to at least 50 percent of the households in the franchise area and competitors enjoy at least a 15% market share; or 3) where a municipally operated system offers video programming to at least 50 percent of the households in that franchise area. Thus, cable systems are immune from rate regulation if they meet any one of these statutory standards.

<sup>7</sup> See Further Notice at ¶ 561.

<sup>8</sup> See Farmers Union Central Exchange, Inc., v. F.E.R.C., 734 F.2d 1486, 1500 (D.C. Cir. 1984), cert. den., Association of Oil Pipelines v. Farmers Union Central Exchange, Inc., 469 U.S. 1034 (1984).

<sup>9</sup> Ethyl Corp. v. EPA, 541 F.2d 1, 36 (D.C. Cir. 1976) (en banc), cert. den. sub nom., E.I. DuPont de Nemours & Co. v. EPA, 426 U.S. 941 (1976).



cable systems under each of the three statutory definitions of effective competition.

That Congress intended to bind the FCC to the Act's definition of effective competition is apparent both from the legislative history and by comparing the 1992 Cable Act to the 1984 Cable Act. Congress had not defined effective competition in the 1984 Act, but left it to the FCC to make that determination. Under the FCC's first definition, a cable system was subject to effective competition if subscribers received three over-the-air broadcast signals.<sup>10</sup> Subsequently, the FCC redefined effective competition to include the existence of either (1) six unduplicated over the air broadcast signals; or (2) an independently owned, competing multichannel video provider that is available to 50 percent of the homes and subscribed to by at least 10 percent of the homes passed.<sup>11</sup> While TCI supported the FCC's definitions in those proceedings, Congress acted otherwise in the 1992 Cable Act.

The legislative history describes in considerable detail Congress' view that the FCC's definitions under the 1984

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<sup>10</sup>

Amendment of Part 1, 63, and 76 of the Commission's

Act should be legislatively altered in the new Act.<sup>12</sup> Citing figures from the General Accounting Office, NCTA, and NTIA, the House and Senate Reports reveal that Congress believed that different definitions should be mandated in order to permit the regulation of a greater number of cable systems. "The Committee does not believe that the FCC's recent decision will afford adequate protection to consumers."<sup>13</sup> More importantly, Congress concluded that the FCC's standard would not "obviate the need for a legislative approach to protecting consumers."<sup>14</sup> Congress' response, therefore, was to adopt its own definition.

By defining effective competition in the Cable Act and, in effect, narrowing significantly the number of cable systems that would be regarded as subject to effective competition, Congress' purpose was clearly to reimpose basic cable service rate regulation for the overwhelming majority of cable systems in the country. The FCC can no more lawfully disregard this objective in determining which cable systems are subject to rate regulation than it can ignore its application in computing the competitive benchmark.

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<sup>12</sup> H.R. Rep. No. 628, 102d Cong., 2d Sess. at 30 (1992) ("House Report"); S. Rep. No. 92, 102d Cong., 2d Sess. at 4-8 (1992) ("Senate Report").

<sup>13</sup> Senate Report at 8.

<sup>14</sup> House Report at 33-34.

B. It is Arbitrary and Capricious for the Commission to Have Applied the Statutory Definitions of Effective Competition to Form Some But Not All of the Data Selection Process

units were not included in the competitive sample[.]<sup>15</sup>

It is clear that by excluding these episodes, the Commission's plan was to apply the statutory definition in a very strict manner. However, it is wholly inconsistent and arbitrary for the Commission to require that data meet an exacting standard under one statutory definition, but to exclude other data that complies fully with another statutory standard. Accordingly, if the Commission refuses to include the rates of cable systems with low penetration levels in its data selection process, it must revisit its decision to exclude these 104 episodes, which admittedly demonstrated "some degree of competition."<sup>16</sup>

Likewise, it would be arbitrary and capricious for the Commission not to consider alternative means of setting the competitive benchmark if it were to exclude any one of the three statutory definitions from the data selection process. Until now, the Commission has never questioned how it would compute the competitive benchmark rate. The original Notice of Proposed Rulemaking assumed, without discussion or suggestions to the contrary, that a competitive benchmark rate would be "defined using the average of rates currently charged by systems facing effective competition, as the Cable Act of 1992 defines that

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<sup>15</sup> See Rate Order, at Appendix E, ¶ 12.

<sup>16</sup> Id.

term."<sup>17</sup> This basic assumption is also reflected in the Order requiring cable operators to submit information on rates and other system characteristics.<sup>18</sup> Schedule 4 of the Order, entitled "Competition in Franchise Areas," solicited information about forms of possible competition in any franchise areas in the system. However, the questionnaire limited those "forms" of competition to the criteria set forth in the statute.<sup>19</sup>

If the Commission now were to exclude cable systems with less than 30 percent penetration from the data selection process, it would be changing a fundamental assumption that the Commission made at the very beginning of this proceeding regarding the procedures it intended to employ to compute the competitive benchmark. Consequently, parties would have to be given an opportunity to present additional material and data to support other means of measuring effective competition for purposes of computing the competitive benchmark. For example,

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<sup>17</sup> See Implementation of Rate Regulation Sections of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd 510, 521-22 (1992) ("Notice") (emphasis added).

The fact that the Commission sought comment on several benchmark alternatives to determine the reasonableness of rates for the basic service tier (e.g., rates of systems subject to effective competition, past regulated rates, 1992 average per-channel rates of cable systems, or the average or typical costs of providing cable service) does not challenge the Commission's basic assumption that a competitive benchmark rate would be based on the rates of cable systems facing effective competition, as defined by the statute. See Notice, 8 FCC Rcd at 521-522.

<sup>18</sup> See Implementation of Rate Regulation Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Survey Order, 8 FCC Rcd 226, Schedule 4 (1992).

<sup>19</sup> Id.

one means of setting this benchmark is to examine the rates of systems in communities with six or more over-the-air signals, which the Commission previously concluded on the basis of quantitative analysis was a meaningful measure of effective competition. Another approach is to survey the prices charged by alternative multichannel video distributors. This is not to suggest that the Commission should choose these specific measures but, rather, to point out that once the Commission elects (assuming again that it can so elect) to ignore the statutory definitions of effective competition in its calculation of the competitive benchmark, it has a duty to reconsider the entire process. And in order to test the validity of alternative sampling measures, further notice-and-comment proceedings are required.<sup>20</sup>

It is well-settled that in promulgating rules an agency's fundamental task is to take a "hard look" at the problem areas and engage in "reasoned decisionmaking," giving consideration to all of the material facts and issues.<sup>21</sup> The Commission would be abdicating its responsibility under the Administrative Procedure Act to engage in such reasoned decisionmaking if it rejected the use of any one of the statutory definitions in the data selection process without reviewing the

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<sup>20</sup> See 5 U.S.C. §§ 553 (b) and (c) (1992).

<sup>21</sup> Greater Boston Television Corp. v. FCC, 444 F.2d 841, 851 (D.C. Cir. 1970), cert. den., 403 U.S. 923 (1971).

entire set of data submitted or considering alternative ways of obtaining effectively competitive rates.

CONCLUSION

The Administrative Procedure Act requires that agency decisions be based on the record and be produced from reasoned decisionmaking. The proposal to require further rate reductions is neither. TCI respectfully submits that the Commission reason its way out of the political maelstrom and reject the proposal of the Further Notice.

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AN ANALYSIS OF THE FCC'S CABLE TELEVISION BENCHMARK RATES



## I. Introduction

The Federal Communications Commission has recently published its benchmark rates for cable television systems. Cable systems with rates that exceed these benchmarks must reduce their rates by 10 percent, or to the benchmark, whichever requires a smaller

municipal franchising authority is a multichannel video programming distributor that offers service to at least half of all households -- the "municipal" systems.<sup>2</sup>

The Commission is now considering whether to re-estimate the "competitive differential" using a sample of effectively competitive systems that excludes those systems with penetration rates below 30 percent.<sup>3</sup> The Commission has indicated that this would increase the differential to about 28 percent, presumably necessitating further reductions in the benchmark rates.

estimate of the competitive differential. To eliminate arbitrarily the low penetration systems from the sample of effectively competitive systems would further reduce our confidence in this estimate. Our estimates of the competitive differential based on different data and another method is closer to the FCC's current estimate than to the one that is obtained if low penetration systems are deleted from the sample.

Before detailing the bases for these conclusions, we cannot help but express both surprise at, and frustration with, the Commission's lack of attention to detail in its management of the data. As a result, we cannot replicate the Commission analysis in its entirety, a most unsettling result given the wide-ranging effects on operators and consumers that the Commission's decision will have. Three days before this filing was due, the Commission supplied us with yet a third data disk that purports to be the "final" dataset used by the Commission. This replaced a second data disk -- which also purported to be the "final" dataset -- provided by the Commission earlier. The second data disk contained missing observations, and many of the variables (particularly the reciprocal of the number of subscribers) appeared to have a substantial number of "zero" entries because of the way the data were rounded. Nowhere in the documentation accompanying this second disk did the Commission explain the rounding problem. In addition, between the time we received the second and third disks, we learned that the Commission apparently provided some parties with yet another disk that did not contain the erroneously rounded

data. And last, but certainly not least, we have been unable to determine precisely how the Commission obtained its final sample, despite repeated conversations with Commission staff.

## II. The FCC's Estimation of Effectively Competitive Rates

The FCC's approach to estimating benchmark rates for basic cable service is to compare the per-channel rates charged by systems deemed subject to effective competition under the 1992 Cable Act with rates charged by a random sample of other systems, holding "other factors" constant.<sup>4</sup> The benchmark rates for systems not subject to effective competition are to be based on estimates of the rates that would be charged by similar systems that are subject to such competition.

Specifically, the Commission's analysis is used to determine the per-channel price of the basic service offerings of cable systems where the offerings include installation, equipment, and

### 1. The Commission's Sample

In conducting its analysis, the Commission initially surveyed 748 "cable community units."<sup>5</sup> Of these, 300 were from a 1 percent random sample of all cable community units. The remainder were drawn from units where there was believed to be at least one other multichannel video service provider, units where cable penetration was believed to be less than 30 percent, and units in the 100 largest cable systems.<sup>6</sup> Data were requested for these community units, for the systems of which these community units were a part, and for a second community unit of the same system.

Responses were received from 708 of the 748 "first" units to which surveys were sent.<sup>7</sup> Of these, 21 were either "duplicates" or had insufficient information, so that the resulting sample contained 687 systems. The Commission also reports that there were an additional 420 observations from a "unique second community unit within the same cable system," resulting in 1,107 "usable different community responses."<sup>8</sup>

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<sup>5</sup>Appendix E -- Survey Results: Technical Issues, p. 1. A cable community unit is probably equivalent to a cable franchise area in most areas. A given cable system may thus contain more than one cable community unit.

<sup>6</sup>This suggests that the Commission initially identified 348 "overbuilt" or "low penetration" systems, 748 - 300 - 100, in the initial sample, although this number is substantially larger than the number of such systems in the sample the Commission analyzed. The Commission's description of its sampling procedure does not refer to specific requests for data from "municipal" systems. According to Appendix E, footnote 9, data on these systems were obtained from the overbuilt and random samples.

<sup>7</sup>Id., p. 3.

<sup>8</sup>Id.

In fact, the Commission's equation used to estimate the competitive differential is based not on these 1,107 responses but on only 377 observations.<sup>9</sup> Observations were eliminated for a number of reasons.

First, the Commission apparently found, on closer examination, that some of the systems it had initially believed were "effectively competitive" did not meet the statutory definition. The Commission reports that there were 104 such community units.<sup>10</sup>

Second, the Commission staff has indicated to us that data from second franchises were included in the database used to estimate the competitive differential only for systems that were eventually classified as effectively competitive.<sup>11</sup> Where non-competitive systems reported data for second franchises, these data were eliminated from the Commission's sample.

Third, the Commission apparently did not use the data from the 100 largest cable systems in its analysis except where it found that they faced effective competition, in which case they were classified as competitive and included in the database. The Commission reports that 1 of the low penetration "first" units, 5 of the low penetration "second" units, 1 of the overbuilt "first"

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<sup>9</sup>Id., p. 12.

<sup>10</sup>Id., p. 5.

<sup>11</sup>As noted above, some of the systems that were initially classified as effectively competitive were eventually deleted from the sample because, on closer examination, it was determined that they did not face effective competition. In addition, some of the systems in the random and top-100 samples were eventually classified as effectively competitive.

units, and 1 of the overbuilt "second" units were obtained from the top-100 sample.<sup>12</sup> The remaining observations for top-100 systems were eliminated.

Finally, an unknown number of observations were eliminated because they did not contain data for all the variables that were included in the equation used by the Commission to estimate the competitive differential.<sup>13</sup>

## 2. The "Rates" that Were Analyzed

The rates analyzed by the Commission are measures of the revenue per subscriber per channel for basic cable services and equipment and installation. For systems that charged combined rates for service and equipment and installation charges, the Commission used those rates. For systems that charged separately for services and equipment and installation, the Commission attempted to add to the service rate an estimate of charges for installation and equipment.<sup>14</sup> Where more than one tier of basic service was offered, the rates for all tiers were combined and a single rate was calculated for each system.

In determining the revenue per subscriber, the Commission

the particular service or type of equipment. Thus, two systems might have the same rates, but one would be found to have higher revenue per subscriber if a larger proportion of its subscribers took an enhanced basic tier, or leased equipment from the operator. Indeed, one system might have lower rates than another but report higher revenues per subscriber if its subscribers took disproportionately large amounts of service or equipment.

### 3. The Commission's Equation

Using these data, the FCC analyzed the differences in rates between the effectively competitive and other units, controlling for differences in the number of system subscribers, the number of channels, and the number of satellite services offered. These variables were apparently chosen using stepwise least squares.<sup>15</sup> In this approach, a collection of candidate explanatory variables is specified and these variables are then entered into an equation in the order of their statistical significance. Presumably the Commission stopped adding variables when this failed to result in a significant reduction in the unexplained variance in rates. The Commission considered a number of other variables "such as density (subscribers per mile) and percentage of plant underground."<sup>16</sup>

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<sup>15</sup>Appendix E, p. 10.

<sup>16</sup>Appendix E, p. 11.



These variables were not included in the Commission's final equation because "either they were not statistically significant or were not consistently so."<sup>17</sup>

The Commission employed a procedure in which the significant explanatory variables were first identified using a sample that did not contain the "effectively competitive" systems. These variables, the number of system subscribers, the number of basic channels, and the number of satellite channels were then included in an equation that was estimated using observations for both "competitive" and "non-competitive" systems, and that contained an additional (binary) variable indicating whether or not an